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*SmartRead...
Revolutionizing
the Water
Business*



*SmartRead . . . Smarter Business
is a concept that
has become a reality.*



Left to right: Vincent G. Mannering, Executive Director,
Dennis DiMarzio, Chair, Board of Commissioners,
Cathleen Douglas Stone, Commissioner,
and Muhammad Ali-Salaam, Commissioner

A Message from the Executive Director

In 2003, the Boston Water and Sewer Commission continued its efforts to provide Boston's consumers with the most efficient water and sewer services. With the introduction of *SmartRead*, the Commission's automated water meter reading system, technological advances will revolutionize how we do business in the city and with our customers. These exciting opportunities will positively impact the day-to-day operations of Boston's water and sewer utility.

Every home and business in Boston is being upgraded with this new technology that will vastly improve water accountability, reduce field visits and help to identify unaccounted for water usage. *SmartRead* generates billing based on actual readings, eliminates "estimated" billing and allows for a proactive customer relationship.

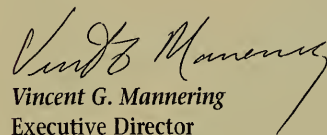
Using the latest technologies, the Commission's workforce has dramatically improved its productivity, enabling us to provide customers the highest quality service at the lowest possible price. *SmartRead*, along with CASS WORKS, (our work order management system) and GIS, (Geographic Information System) allows the Commission to maintain its "best in class" utility status.

During 2003, our Capital Improvement Program to rehabilitate our water and sewer delivery systems remained an important priority for the Commission, our customers and our environment. The Commission is steadfast in its commitment to upgrade its infrastructure and reduce pollution levels in local water resources. We are committed to our mandate of providing a safe, efficient and reliable public water and sewer system.

Our staff is committed to the "nuts and bolts" of our business, recognizing that the way to achieve our fiscal, public service and environmental goals is through strict attention to details and customer satisfaction. While technology positively impacts our operational budget, providing first class service to our customers remains our focus.

Much of our success is due to the strong support of Mayor Thomas M. Menino whose leadership allows us to operate a public utility that Boston's residents can be proud of. I am confident we can uphold the Commission's tradition of excellence today and in the coming years.

Sincerely,



Vincent G. Mannering
Executive Director

Moving Ahead with Technology

A SmartRead water meter is installed along with a meter transmission unit at the residence or place of business. The information is then passed to the data collection unit by way of radio frequency transmission.



Today, technology plays a pivotal role in the water utility business, setting new standards for innovation and effective customer service.

Customer service is our top priority and through the utilization of technology, we are moving ahead by incorporating various elements of new technology. This will

greatly benefit our “bottom line” and effectuate a process that allows for a more proactive approach to customer service!



The Commission has always been, and continues to be, dedicated to advancing its technological capabilities that will provide the tools to be a more productive, effective workforce and to enhance the convenience factor for our customers.

SmartRead... Smarter Business

SmartRead, a citywide automated water meter reading system, is being installed into every home and business in Boston. *SmartRead* utilizes radio frequencies to transmit data from the customers' water meter back to the Commission without the use of vehicles or personnel. The Commission successfully pilot tested *SmartRead* technology in over 1400 homes throughout the city in 1998. The result of the pilot was an actual read rate in excess of 99%.

SmartRead will lead to the virtual elimination of estimated bills, the #1 customer complaint. The new system allows the Commission to identify leaks in a more timely fashion, improve fire protection and increase water conservation.

The Commission's new automated water meter reading system is state-of-the-art technology that includes a new water meter, a meter transmission unit (MTU) and a data collection unit (DCU) utilizing a dedicated, secure radio frequency and cellular wireless technology. Boston Public School buildings throughout the city have been equipped with DCU's since most are situated at the highest point in their particular neighborhood. DCU's were also installed on other buildings where additional coverage was needed. *SmartRead* is an important capital

investment that will allow the Commission to heighten its efficiency and effectiveness.

The Commission and its contractor have been installing this state-of-the-art technology throughout the neighborhoods of Boston with positive results. Thus far, 98% of our 88,000 accounts have been upgraded and *SmartRead* will be fully deployed by the end of 2004. The new system offers exciting opportunities for our customers and for the everyday business operations of our water and sewer utility.

Revolutionizing the Water Business

SmartRead presents a unique opportunity for the Commission to deliver an *effective, smarter and more convenient* system for improving customer service!

Our customers have experienced an immediate improvement with *SmartRead* by receiving bills based on actual usage every month instead of alternating estimated bills. This alone has reduced customer complaints by 40%.

SmartRead allows the Commission to increase its efforts to conserve water and ensure water equity. The automated recording of water usage in Boston will enhance the review and assessment of account activity relative to unaccounted for water, reduce the probability of defective water meters and identify anomalies that may be apparent at a particular property. It will ensure a higher level of service and equitable water distribution for every customer of the Boston Water and Sewer Commission. Indeed, *SmartRead* saves money

and valuable resources making it a cost effective asset for the Commission, its bond holders and its ratepayers.

Revenue Auditing

SmartRead will save the utility about \$2M in labor costs, recover lost revenue by identifying unaccounted for water and allow the Commission to increase its efforts to stop theft of service. Meter work orders, which average 50,000 per year, will be reduced by 75% as a result of employing a proactive approach to customer

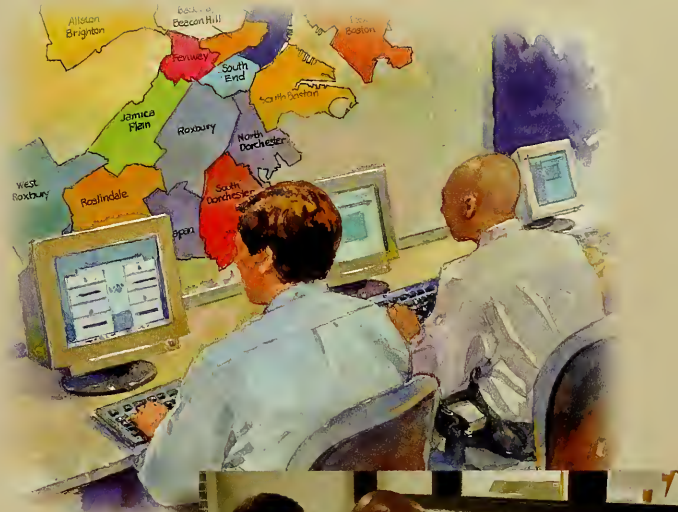
service and system maintenance. *SmartRead* positively impacts our bottom line!

Large users may also have the capability of accessing their accounts to view overnight, daily, negative, average or unusually high/low water consumption at various properties at any time. The possibility also exists for weekly analysis and water meter readings being emailed to large users for their review. The Commission is committed to improving its financial outlook while reducing expenses for the benefit of our customers and our business. Opportunities for additional revenue sources are available as a result of *SmartRead* including the potential for on-line data analysis, leak monitoring and processing meter reading data for other municipalities.

The data collection units, mounted on the roofs of schools throughout the city, transmit data to Boston Water and Sewer Commission headquarters.



The computer system collects the information, and directs data into each account.



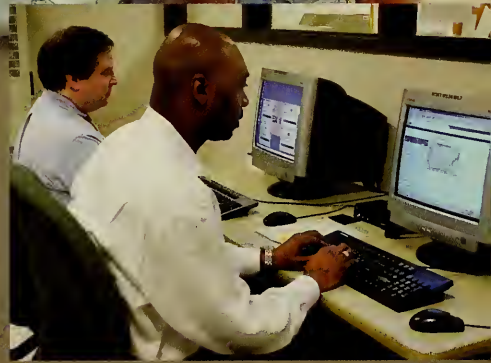
In an effort to reduce illegal or inconsistent water service, the Commission will strengthen its efforts to employ a systematic auditing of accounts to prevent leaks and theft of service. *SmartRead* allows the Commission to compare consumption for similar users, identify illogical consumption trends and investigate zero consumption. The combined capabilities of GIS and *SmartRead* technologies will link customer accounts to determine area consumption trends in response to questionable water consumption.

A Commitment to Capital Improvements

The Commission holds the responsibility for the operation and maintenance of the water distribution, wastewater collection and storm water drainage systems in the City of Boston.

Our most vital objectives as a public water utility continue to be the adequate delivery of high quality potable water for consumption, fire protection, the efficient and environmentally sound collection of wastewater for transport and delivery to a treatment facility.

The 2003-2005 Capital Improvement Program identifies capital expenditures totaling \$165M. Water Distribution projects account for \$54M, or 32.3%, of the 2003-2005 CIP. Sewer System projects comprise \$79.8M, or 47.6%, and Support projects total \$33.7M, or 20.1%, of the expenditures outlined in the program.



Water Distribution projects include relaying aged, undersized or structurally deteriorated pipes and relining structurally sound pipes by cleaning out any interior residue and installing a cement lining. Sewer System projects include repair or replacement of deteriorated or collapsed sanitary sewers and storm drains along with television inspection of 15 to

Bills are generated, showing a detailed account of water usage for the month.



20 miles of sewer pipe each year. Also, the CIP continues to fund the separation of combined sewers and for the reduction of infiltration and inflow into the sanitary system. The Commission, under

agreement with the Massachusetts Water Resources Authority, is actively pursuing to eliminate and substantially close combined sewer overflows through sewer separation projects in Dorchester, Stony Brook area in Jamaica Plain and the Constitution Beach area in East Boston.

Support projects in the CIP include on-going facility projects, meter projects and improvements to the Commission's computer infrastructure, including software and hardware systems. The Geographic Information System continues to be a major element for the 2003-2005 CIP.

Technology at Work

Significant advances in technology over the past several years have made a substantial impact to the Commission's capabilities relating to information accessibility. Several new utility-wide applications have been implemented including the Automated Meter Reading (*SmartRead*) system and the Work Order Management System (CASS WORKS) to track inventory. Both of these new applications are tightly integrated with the Commission's GIS in such a way that users are able to visualize



and analyze trends in data with the added dimension of property location.

CASS WORKS has been operational since January 2002 allowing the Operations Division and Field Engineering Department to create work orders when crews perform any type of maintenance to the system's infrastructure. Work orders are stored in a centralized database permitting staff in any department to quickly and accurately retrieve information on work performed, completed or in progress. *SmartRead* helps the Commission to integrate its information technology with each customer account to analyze consumption trends, identify consumption anomalies, detect possible leaks and property location analysis through GIS.

The Future is Here! Improved Customer Service and Convenience

The Commission's technological upgrades and integration allow for a vast array of new applications that will certainly enhance the effectiveness of our water and sewer operations and improve the efficiency of delivering quality customer service. Our new capabilities create a unique opportunity to offer ratepayers services that have been consistently requested over the years. The time has arrived to ensure that our #1 priority of providing the best possible customer service becomes a reality!

SmartRead, CASS WORKS and GIS have enhanced our internal operations that certainly impact the "bottom line" and our business practices; however, it is our

customers who greatly benefit from our technological advances.

One of the most requested services by our customers will soon become a reality. On-line account access will allow our residential and commercial customers to review their water consumption, payment history and communicate with our customer service representatives via e-mail anytime, day or night.

On-line bill payment offers the convenience of eliminating check books, stamps, and envelopes.

*SmartRead . . .
improves service
for both our
residential
and commercial
customers.*

Customer reviews account activity and has the option of paying by check or online.



Customers would be able to view their bills from anywhere with on-line access. The Commission will also have the capability to link accounts that are registered for on-line billing and payment to reduce mailing costs positively impacting the overall financial outlook of the Commission.

Improved customer convenience and service is a direct result of our capital investments and it is paying huge dividends for all concerned. New technology and new customer service initiatives ensure a more customer-friendly approach to providing the best possible delivery of water and sewer services to Boston's ratepayers.

Getting the job done is our top priority and technology offers possibilities that were not available just a few years ago.

The Commission is dedicated to providing the best possible customer service while continuing to improve the water and sewer infrastructure throughout the city. Our commitment in 2003 has produced positive results for our customers and for Boston. We will strive to produce even more in 2004.

Independent Auditor's Report

The Commissioners Boston Water and Sewer Commission

We have audited the accompanying statements of net assets of the Boston Water and Sewer Commission (the Commission) as of December 31, 2003 and 2002, and the related statements of operations and cash flow for the years then ended. These financial statements are the responsibility of the Commission's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis,

evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Commission at December 31, 2003 and 2002, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 10 through 13 is not a required part of the basic financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain

limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were made for the purpose of forming an opinion on the basic financial statements. The accompanying supplemental schedules are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in our audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

KPMG LLP

March 31, 2004

Management's Discussion and Analysis

Required Supplementary Information,
December 31, 2003 and 2002

Since its creation in 1977, The Boston Water and Sewer Commission (the Commission) assumed the responsibility to provide water distribution, wastewater collection and storm water drainage services in the City of Boston (the City).

The Commission has realized surplus from its operation in each year since its inception. In accordance with the Boston Water and Sewer Reorganization Act of 1977, the Commission applies audited surpluses to reduce its rates in succeeding years.

To accommodate the rate making process, the Commission follows the accounting standards set forth in Statement of Financial Accounting Standards (SFAS) No. 71. SFAS No. 71 allows certain (a) revenues provided for future allowable costs to be deferred until the costs are actually incurred (deferred credits) and (b) costs incurred to be capitalized if future recovery is reasonably assured (deferred charges).

The statement of net assets provides information on the assets and liabilities of the Commission, with net assets reported as the difference between assets and liabilities. The statement of operations of the Commission reflects all revenues earned and all expenses incurred for each of the years ended December 31, 2003 and 2002.

Condensed financial information for the three most recent years is presented in this section of the report.

	2003	2002*	2001*
Current assets	\$27,371,123	27,527,877	23,727,006
Capital assets, net	686,412,129	627,393,255	589,487,908
Other assets	230,477,452	280,074,598	303,994,651
Total assets	944,260,704	934,995,730	917,209,565
Current liabilities	37,587,106	31,755,677	32,127,384
Noncurrent liabilities	695,411,346	717,989,162	722,037,239
Total liabilities	732,998,452	749,744,839	754,164,623
Net assets:			
Invested in capital assets, net of related debt	379,695,558	318,390,253	277,724,297
Restricted net assets	75,559,717	83,636,998	92,815,077
Unrestricted net assets	(243,993,023)	(216,776,360)	(207,494,432)
Total net assets	\$211,262,252	185,250,891	163,044,942

*Certain reclassifications were made to the 2002 and 2001 information to be comparative with the current year presentation.

In 2003, the Commission's net assets totaled \$211.3 million, an increase of \$26.0 million, or 14.0% from FY 02 and in 2002 net assets totaled \$185.3 million an increase of \$22.2 million, or 13.6% from FY 01. The Commission recognized statutory surplus of \$0.5 million in FY 03 and \$0.4 million in both FY 02 and FY 01. Total assets in FY 03 were \$944.3 million, an increase of \$9.3 million, or 1.0% from last year's FY 02 total assets of \$935.0 million. In FY 02 total assets were \$935.0 million, an increase of \$17.8 million, or 1.9% from FY 01 total assets of \$917.2 million. The Commission invested in various capital assets, including capital improvement projects, machinery and equipment, buildings and improvements. These investments totaled \$686.4 million, up \$59.0 million, or 9.4% over FY 02's total investment in capital assets. In FY 02 these investments totaled \$627.4 million, up \$37.9 million, or 6.4% over FY 01's total investment in capital assets.

Water and sewer charges in FY 03 represented 92.4% of operating revenues. Water and sewer charges totaled \$205.0 million, which was \$17.9 million, or 9.6% higher than the same period the prior year, due primarily to a rate increase of 12.8% in water and sewer charges in 2003. In 2003, the Commission implemented two rate increases one for 8.9% in January and 3.9% in April. This was due to the special assessment from the Massachusetts Water Resources Authority (MWRA) and the elimination of the debt service assistance program from the Commonwealth of Massachusetts. The Commission accrued billing adjustments at 2.75% and bad debts at 0.3% of accrued water and sewer charges for the year. Additionally discounts were accrued at 1.0% of unbilled water revenue. Total operating revenues in FY 03, which includes fire pipe and other revenues, totaled \$221.9 million, representing an increase in total operating revenue of \$17.5 million, or 8.6% higher than the same period the prior year.

In FY 02 water and sewer charges represented only 91.5% of operating revenues. They totaled \$187.1 million, which is \$14.0 million, or 8.1% higher than water and sewer charges in FY 01, due to a combined rate increase of 8.9% in water and sewer charges in 2002. The Commission accrued billing adjustments at 3.0% and bad debts at 0.5% of accrued water and sewer charges for the year. Additionally discounts were accrued at 1.0% of unbilled water revenue. Total operating revenues in FY 02, which includes fire pipe and other revenues, totaled \$204.4 million, representing an increase in revenue of \$17.8 million, or 9.5% higher than FY 01 revenue.

Direct operating expenses in FY 03 totaled \$203.9 million, which was \$11.1 million or 5.7% over direct operating expenses for the same period in FY 02. This increase was due primarily to a substantial increase in the MWRA assessment. Investment income decreased by \$7.5 million in 2003, offset slightly by a decrease of \$1.3 million in interest paid, reflecting the low interest rate environment in FY 03. In FY 02 direct expenses totaled \$192.8 million, which is \$8.9 million, or 4.9% over FY 01. Investment income decreased by \$5.6 million in 2002, offset slightly by a decrease of \$1.0 million in interest paid.

	2003	2002*	2001*
<i>Operating revenues</i>	\$221,915,418	204,389,352	186,596,187
Operating expenses	203,889,999	192,848,177	183,918,265
Excess operating revenues	18,025,419	11,541,175	2,677,922
Nonoperating expenses	(11,327,734)	(5,118,090)	(503,841)
Excess revenues before capital grants and contributions and transfer requirements	6,697,685	6,423,085	2,174,081
Capital grants and contributions	29,352,147	25,169,818	12,244,871
Excess revenues used to fund reserves and other deferrals	(9,949,275)	(9,369,771)	(14,364,997)
Change in accumulated revenues used to offset future rates	(89,196)	(17,183)	9,453,145
Change in net assets	26,011,361	22,205,949	9,507,100
Net assets, beginning of year	185,250,891	163,044,942	153,537,842
Net assets, end of year	\$211,262,252	185,250,891	163,044,942

Management's Discussion and Analysis

Required Supplementary Information,
December 31, 2003 and 2002

Capital Assets

In fiscal year 2003, major Commission's infrastructure project additions totaled \$30.2 million, of which \$14.0 million were financed with bond proceeds as follows:

Relay of water mains	\$7.5M
Reline of water mains	\$1.5M
Rehabilitation/replacement of sewers or storm drains	\$6.5M
Interceptor improvements	\$0.4M
Separation of combined sewers	\$2.5M
Infiltration and inflow	\$0.8M
Meter replacement	\$11.0M

The Commission's 2004-2006 capital budget includes projected expenditures of \$177.5 million for infrastructure and capital projects. The major projects are for the rehabilitation of water mains and the replacement/rehabilitation of the sewer system along with the installation of a new radio frequency meter reading system. Some water projects are financed on a pay-as-you-go cash basis combined with an interest free loan for water rehabilitation provided by the MWRA. The majority of the sewer improvements along with the installation of a new radio frequency meter reading system will be financed through bond proceeds. However there are sewer improvements that are funded through the utilization of the MWRA loan programs.

More detailed information about the Commission's capital assets is presented in note 3 to the financial statements.

Debt Plan

The Commission is empowered by the Boston Water and Sewer Reorganization Act of 1977 (the Enabling Act) to issue bonds and notes payable solely constituted on the general obligation of the Commission. The Commission has no legal restrictions concerning the amount of debt, which it may have outstanding, subject to the coverage requirements described below.

The Commission issues General Revenue Bonds to finance portions of its capital improvement projects. The Commission's 2004-2006 capital budget, which totals \$177.5 million, anticipates that projects totaling \$103.7 million, or 58.4% of the Commission's 2004-2006 capital budget, will be funded from bond proceeds. The 2004 budget for debt service is \$30.5 million.

The Commission currently has seven series of General Revenue Bonds outstanding at the end of 2003; totaling approximately \$300.6 million.

\$30.8 Million	1992 Series A
\$46.7 Million	1993 Series A
\$34.3 Million	1994 Series A
\$13.0 Million	1998 Series A
\$11.3 Million	1998 Series C
\$120.2 Million	1998 Series D
\$15.4 Million	2002 Series A
\$28.9 Million	2003 Series A

More detailed information about the Commission's long-term obligations is presented in note 4 to the financial statements

In 2003, the Commission completed a successful refunding of the callable portion of the 1993 Series A Bonds, which generated a net present value savings of \$16.3 million.

Debt Service Coverage Requirements

The Commission's bond covenant requires that rates and charges be at least sufficient to provide revenues (i) to pay all current expenses of the Commission, (ii) to pay the principal of, premium if any, and interest on all bonds issued by the Commission as they become due and payable, (iii) to create and maintain such reasonable reserves as may be reasonably required by any trust agreement or resolution securing bonds, (iv) to provide funds for paying the cost of all necessary repairs, replacements and renewal of the systems and (v) to pay or provide for any and all amounts which the Commission may be obligated to pay or provide for by law or contract. The Commission is also required to establish and maintain rates and charges at levels sufficient so that total net revenues in each year during which bonds are outstanding will equal at least 125% of (1) the bond debt service requirement during such year less (2) the amount, if any, of bond proceeds available to pay interest becoming due in such year on bonds outstanding as of the first day of such year. The Commission has exceeded the 125% debt service coverage requirement of the Resolution in each year since its inception in 1977.

Additional Bonds and Refunding Bonds

The Enabling Act permits the issuance of additional bonds for paying the cost of any project, making deposits in various funds established under the Enabling Act, paying costs of issuance, paying the principal, premium and interest on any notes issued in anticipation of additional bonds, or any combination of the above.

Refunding bonds may also be issued by the Commission only upon certifying that the aggregate debt service in each fiscal year in which Refunding Bonds are outstanding will not be increased as a result of the issuance of the Refunding Bonds; provided that, in lieu of such certification, the Commission may deliver to the Trustee certificates satisfying the conditions described above for the issuance of additional bonds.

Next year's budgets and rates

The Commission from 1994 to 2001 was able to maintain its water and sewer rates to its customers without an increase. Additionally, the Commission is required by law to be self-sustaining, to set its rates at a level sufficient to cover expenses and debt service requirement each year. The Commission instituted a rate increase of 8.9% in fiscal year 2002. In fiscal year 2003 a rate increase of 8.9% was implemented on January 1st and another rate increase of 3.9% on April 1st. As a result, the total increase in water and sewer rates for fiscal year 2003 was 12.8%. The April increase was due to special assessment from MWRA and the elimination of the debt service assistance program from the Commonwealth of Massachusetts. On January 1, 2004 the water and sewer rate increased by a combined 5.8%. The major reasons behind these increases are: (i) the increase in assessment paid to the MWRA, and (ii) the decline in water sales due to general water conservation efforts of individuals and businesses throughout the City.

Statements of Net Assets

December 31, 2003 and 2002

	2003	2002
Assets		
Current assets:		
Cash and cash equivalents (note 9)	\$8,135,734	9,340,446
Accounts receivable, net:		
Customers, less allowances of \$5,435,458 in 2003 and 2002 (note 1)	8,128,780	7,567,520
Unbilled revenues, less allowances of \$1,702,361 in 2003 and 2002	9,334,029	8,873,762
Construction grants receivable	1,279,663	1,325,497
Prepaid expenses	492,917	420,652
Total current assets	27,371,123	27,527,877
Noncurrent assets:		
Restricted cash and investments (notes 4 and 9)	207,173,685	252,141,542
Capital assets:		
Depreciable, net (note 3)	511,515,378	481,188,905
Nondepreciable (note 3)	174,896,751	146,204,350
Deferred charges (note 2)	21,375,118	25,775,674
Bond issue costs, net	1,928,649	2,157,382
Total noncurrent assets	916,889,581	907,467,853
Total assets	944,260,704	934,995,730
Liabilities		
Current liabilities:		
Payable from current assets:		
Accounts payable	15,830,813	11,200,001
Other accrued liabilities	5,710,434	5,568,561
Current portion of long-term notes (note 4)	5,690,859	5,207,115
Current portion of revenue bonds (note 4)	10,355,000	9,780,000
Total current liabilities	37,587,106	31,755,677
Noncurrent liabilities:		
Long-term debt, net (note 4)	283,067,334	310,577,189
Long-term notes payable (note 4)	44,096,735	38,527,699
Other long-term liabilities	10,552,258	18,884,754
Deferred credits and reserves (note 2)	357,695,019	349,999,520
Total noncurrent liabilities	695,411,346	717,989,162
Total liabilities	732,998,452	749,744,839
Net Assets		
Net assets:		
Invested in capital assets, net of related debt	379,695,558	318,390,253
Restricted for debt service	31,070,812	41,230,234
Restricted for capital assets	3,666,284	4,534,304
Restricted for debt covenants	40,822,621	37,872,460
Unrestricted net assets	(243,993,023)	(216,776,360)
Commitments and contingencies (notes 10, 11, 12, and 13)		
Total net assets	\$211,262,252	185,250,891

See accompanying notes to financial statements.

Statements of Operations

Year ended December 31, 2003 and 2002

	2003	2002
<i>Operating revenues:</i>		
Water and sewer usage	\$205,000,340	187,074,121
Fire pipe	3,108,779	2,922,124
Other	13,806,299	14,393,107
Total operating revenues	221,915,418	204,389,352
<i>Operating expenses:</i>		
Operations	45,156,684	46,135,304
Maintenance	7,704,164	6,974,382
MWRA assessment (note 6)	135,185,604	122,737,010
Depreciation and amortization	15,843,547	17,001,481
Total operating expenses	203,889,999	192,848,177
Excess operating revenues	18,025,419	11,541,175
<i>Nonoperating revenue (expense):</i>		
Investment income	4,243,091	11,709,410
Interest expense	(15,570,825)	(16,827,500)
Total nonoperating expense	(11,327,734)	(5,118,090)
Excess revenues before capital grants and contributions and transfer requirements	6,697,685	6,423,085
Capital grants and contributions	29,352,147	25,169,818
Excess revenues before transfer requirements	36,049,832	31,592,903
Excess revenues used to fund reserves and other deferrals (note 2)	(9,949,275)	(9,369,771)
Change in accumulated revenues used to offset future rates (note 2)	(89,196)	(17,183)
Change in net assets	26,011,361	22,205,949
Net assets, beginning of year	185,250,891	163,044,942
Net assets, end of year	\$211,262,252	185,250,891

See accompanying notes to financial statements.

Statements of Cash Flows

Year ended December 31, 2003 and 2002

	2003	2002
<i>Cash flows from operating activities:</i>		
Receipts from customers	\$206,498,608	193,559,454
Payments to suppliers	(157,352,324)	(146,365,943)
Payments to employees	(27,948,666)	(31,618,396)
Net cash provided by operating activities	21,197,618	15,575,115
<i>Cash flows from investing activities:</i>		
Investment income	4,243,091	11,709,410
Net cash provided by investing activities	4,243,091	11,709,410
<i>Cash flows from capital and related financing activities:</i>		
Purchase of capital assets	(73,025,336)	(51,725,764)
Proceeds from debt	34,982,780	24,527,155
Payment of bond principal	(47,352,044)	(27,960,000)
Capital contributions	29,352,147	25,169,817
Payment of bond interest	(15,570,825)	(16,827,500)
Net cash used in capital and related financing activities	(71,613,278)	(46,816,292)
Net decrease	(46,172,569)	(19,531,767)
Cash, cash equivalents, restricted cash and investments, beginning of year	261,481,988	281,013,755
Cash, cash equivalents, restricted cash and investments, end of year	\$215,309,419	261,481,988
<i>Reconciliation of operating income to net cash provided by operating activities:</i>		
Excess operating revenues	\$18,025,419	11,541,175
Adjustment to reconcile operating income to net cash:		
Excess revenues used to fund reserves and other deferrals	(10,038,471)	(9,386,954)
Depreciation and amortization	15,843,547	17,001,481
Change in assets and liabilities:		
Accounts receivable, net	(561,260)	563,047
Unbilled revenues	(460,267)	(1,963,177)
Construction grants receivable	45,834	(42,815)
Prepaid expenses	(72,264)	(89,638)
Accounts payable	4,630,812	(988,634)
Other accrued liabilities	141,873	(339,163)
Deferred credits and reserves	1,974,891	8,361,943
Other long-term liabilities	(8,332,496)	(9,082,150)
Net cash provided by operating activities	\$21,197,618	15,575,115
See accompanying notes to financial statements.		

Notes to Financial Statements

December 31, 2003 and 2002

(1) Organization, Basis of Presentation, and Summary of Significant Accounting Policies

The Boston Water and Sewer Commission (the Commission) has the responsibility to provide water and wastewater services on a fair and equitable basis in the City of Boston (the City) as required under the Boston Water and Sewer Reorganization Act of 1977 (the Enabling Act).

Under the Enabling Act, the Commission is subject to regulation with respect to rates, accounting and other matters, where applicable, by the board of commissioners (the Board). The Board is appointed by the City's Mayor subject to confirmation by the City Council. It regulates the rates that the Commission can charge its customers for water and sewer usage. The rates charged to customers are based on the cash required for the Commission's operations, debt service, and reserve contributions. However, there is no legally adopted budget that the Commission must adhere to. To comply with the external financial reporting requirements of the Board, the accompanying financial statements are presented on a basis that is consistent with generally accepted accounting principles (GAAP) for regulated utilities (i.e., the accrual basis of accounting and the capital maintenance measurement focus).

To accommodate the rate-making process, the Commission follows the accounting standards set forth in Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain Types of Regulation*. SFAS No. 71 allows certain (a) revenues provided for future allowable costs to be deferred until the costs are actually incurred (deferred credits) and (b) costs incurred to be capitalized if future recovery is reasonably assured (deferred charges). Revenues and expenses appearing in the supplemental schedule of revenues and expenses – rate basis are presented in the same format as utilized in the Commission's operational budgeting and rate-setting process. The revenues and expenses shown on the statements of operations are presented on a GAAP basis. A reconciliation between the revenues and expenses of these two operating statements for the year ended December 31, 2003 is provided below:

	Revenues	Expenses
As presented in the statements of operations:		
Operating revenues/expenses	\$221,915,418	203,889,999
Other revenues/expenses	4,243,091	15,570,825
Total	226,158,509	219,460,824
Reclassifications and deferrals:		
Contributions to reserves	—	855,201
Revenue adjustments/bad debt expense	(7,750,359)	(7,750,359)
Excess bond payments over depreciation and amortization	—	(698,201)
Interest expense (escrowed funds)	—	(974,797)
Investment income (escrowed funds)	3,602,060	—
Capital expenditures	—	10,768,406
Excess revenue used to offset current rates	438,608	—
Other deferrals	—	259,940
As presented in the supplemental schedule	\$222,448,818	221,921,014

The Enabling Act requires that any net surplus, as defined by the rate-setting process, be either turned over to the City or applied to offset water and sewer rates for the following year. The Commission has applied \$527,804 and \$438,608 for the years ended December 31, 2003 and 2002, respectively, to offset rates in the respective subsequent years.

(a) Revenue Billings

Water and sewerage fees are billed to users of the systems on a monthly cycle basis. Revenues are accrued for periods between the termination of billings for the various cycles and the end of the year. Various adjustments are made on a post-billing basis that reduce the amount of total billings. Accordingly, the 2003 and 2002 total customer bills outstanding of \$23,584,018 and \$23,022,758, respectively, have been reduced by provisions for billing adjustments and sewer abatements of \$10,019,780 in 2003 and 2002. These net billing amounts are further reduced by an allowance for uncollectible accounts of \$5,435,458 in 2003 and 2002, to arrive at net accounts receivable.

Notes to Financial Statements

December 31, 2003 and 2002

(b) Investments

Investments are stated at fair value. Fair value is determined based on quoted market price.

(c) Capital Assets

Capital assets are stated at historical cost. Depreciation is provided on the straight-line method based upon the estimated useful lives of the various classes of assets. Maintenance and repairs are charged to expense as incurred. Major renewals or betterments over \$500 are capitalized and depreciated over their estimated useful lives.

The Commission capitalizes interest costs during construction of assets for its own use. No interest was capitalized in 2003 or 2002 because the amount calculated was not material.

(d) Compensated Absences

Various employees of the Commission accumulate unused sick time (subject to certain limitations) to be used at a later date or a percentage paid in cash upon voluntary resignation and/or retirement from the Commission (subject to Commission policies and/or bargaining agreements.) The liability for vacation leave is based on the amount earned but not used; for sick leave, it is based on a percentage of the amount accumulated at the balance sheet date. The liability for both amounts is calculated based on the pay or salary rates in effect at the balance sheet date.

(e) Depreciation

The Commission provides for depreciation using the straight-line method. Estimated useful lives used in computing depreciation are as follows:

	Years
Water:	
Works	100
Meters	10
Hydrants	40
Sewerage:	
Works	75
Pumping station	35
Buildings	40
Other	4 to 14

(f) Capital Grants and Contributions

The Commission receives capital grants and contributions from governmental agencies, individuals, and the City in aid of specific construction projects. In fiscal 2001, the Commission adopted GASB Statement No. 33, Accounting and Financial Reporting for Nonexchange Transactions, which requires capital grants and contributions to be reported as capital contribution revenue. The amount recorded as revenue in fiscal 2003 and 2002 was \$29,352,147 and \$25,169,818, respectively.

(g) Cash Equivalents

The Commission considers all highly liquid, short-term cash investments with original maturities of three months or less to be cash equivalents for purposes of the statements of cash flows.

(h) Bond Issue Costs

Expenses related to the issuance of bonds are amortized on a weighted average basis over the life of the bonds, which approximates the effective interest method.

(i) **Proprietary Activity Accounting and Financial Reporting**

Under the Governmental Accounting Standards Board (GASB) Statement No. 20, Accounting and Financial Reporting for Proprietary Activities, the Commission has elected to apply all Financial Accounting Standards Board (FASB) statements and interpretations issued on or before November 30, 1989 except those that conflict with or contradict GASB pronouncements.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses result from providing services in connection with ongoing operations. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

(j) **Use of Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities, at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(k) **Reclassifications**

Certain 2002 amounts have been reclassified to conform with the 2003 presentation.

(2) Deferred Charges and Credits

As discussed in note 1, the application of SFAS No. 71 results in certain revenues and expenses being removed from the statements of operations and reflected in the statement of net assets as deferred charges or deferred credits. The revenues and expenses that have been removed from the statements of operations and added to the statements of net assets as deferred charges or credits appear in the line "Excess revenues used to fund reserves, and other deferrals" on the statements of operations. The components of these amounts, which are based on approval of the Board of Commissioners, are as follows:

	2003	2002
Contributions to reserves	\$855,201	—
Provision for working capital	—	(570,428)
Provision for capitalized interest	—	(154,593)
Principal payments on long-term debt	14,518,527	13,580,172
Interest paid from escrow funds	(974,798)	(1,030,056)
Capital expenditures	10,768,406	8,900,324
Depreciation and amortization	(12,502,761)	(14,037,612)
Investment income on project and escrow funds	(3,602,058)	2,533,616
Other	886,758	148,348
	\$9,949,275	9,369,771

The components of deferred charges included in the accompanying statement of net assets are as follows:

	2003	2002
Deferred loss on land taking	\$5,747,733	5,968,799
Accrued pension expense	11,808,209	12,394,168
Debt extinguishment expense	3,819,176	7,412,707
Total deferred charges	\$21,375,118	25,775,674

Notes to Financial Statements

December 31, 2003 and 2002

The activity in and components of deferred credits and reserves included in the accompanying statement of net assets are as follows:

	December 31, 2002	Increase (decrease)	December 31, 2003
Debt service	\$124,445,837	855,201	125,301,038
Capital improvements	198,346,649	9,094,073	207,440,722
Working capital	24,528,426	(2,342,971)	22,185,455
Self-insurance	2,240,000	—	2,240,000
	349,560,912	7,606,303	357,167,215
Reduction of future rates	438,608	89,196	527,804
Total deferred credits and reserves	\$349,999,520	7,695,499	357,695,019

(3) Capital Assets

The cost and activity of water and sewerage capital assets in service and related accumulated depreciation at December 31, 2003 and 2002 is as follows:

	Balance at December 31, 2002	Increases	Decreases	Balance at December 31, 2003
<i>Capital assets, not being depreciated:</i>				
Land	\$2,519,243	—	—	2,519,243
Construction in progress	143,685,107	71,395,248	42,702,847	172,377,508
Total capital assets not being depreciated	146,204,350	71,395,248	42,702,847	174,896,751
<i>Capital assets, being depreciated:</i>				
Buildings and improvements	59,730,528	1,120,464	—	60,850,992
Machinery and equipment	21,979,210	795,509	272,355	22,502,364
Infrastructure	537,305,662	42,431,442	—	579,737,104
Total capital assets being depreciated	\$619,015,400	44,347,415	272,355	663,090,460
<i>Less accumulated depreciation for:</i>				
Buildings and improvements	\$2,397,760	1,617,441	—	4,015,201
Machinery and equipment	14,797,209	2,076,821	231,494	16,642,536
Infrastructure	120,631,526	10,285,819	—	130,917,345
Total accumulated depreciation	137,826,495	13,980,081	231,494	151,575,082
Total capital assets being depreciated, net	481,188,905	30,367,334	40,861	511,515,378
Capital assets, net	\$627,393,255	101,762,582	42,743,708	686,412,129

	Balance at December 31, 2001	Increases	Decreases	Balance at December 31, 2002
<i>Capital assets, not being depreciated:</i>				
Land	\$2,519,243	—	—	2,519,243
Construction in progress	102,640,327	52,889,919	11,845,139	143,685,107
Total capital assets not being depreciated	105,159,570	52,889,919	11,845,139	146,204,350
<i>Capital assets, being depreciated:</i>				
Buildings and improvements	57,163,359	2,567,169	—	59,730,528
Machinery and equipment	21,020,097	959,113	—	21,979,210
Infrastructure	528,990,646	8,315,016	—	537,305,662
Total capital assets being depreciated	607,174,102	11,841,298	—	619,015,400
<i>Less accumulated depreciation for:</i>				
Buildings and improvements	846,237	1,551,523	—	2,397,760
Machinery and equipment	12,501,524	2,295,685	—	14,797,209
Infrastructure	109,498,003	11,133,523	—	120,631,526
Total accumulated depreciation	122,845,764	14,980,731	—	137,826,495
Total capital assets being depreciated, net	484,328,338	(3,139,433)	—	481,188,905
Capital assets, net	\$589,487,908	49,750,486	11,845,139	627,393,255

During 1999, the Boston Redevelopment Authority (BRA) took land owned by the Commission through eminent domain. The book value of the land, at the time of the taking, was \$7,598,710. A portion of this loss, \$6,632,000, has been included in deferred charges in the accompanying statements of net assets as that amount will be recovered through future rates. The Commission was paid no compensation for the land and does not expect to receive any consideration from BRA in the future.

Notes to Financial Statements

December 31, 2003 and 2002

(4) Long-Term Obligations

The Commission issues revenue bonds to support various projects. The following is a summary of revenue bond activity for the years ended December 31, 2003 and December 31, 2002 (amounts in thousands).

Description	Balance at December 31, 2002	Additions	Reductions	Balance at December 31, 2003
<i>Revenue bonds:</i>				
1992 Series A, bearing interest rates ranging from 5.5% to 5.75%, with maturity dates ranging from November 1, 2003 to 2013	\$30,810	—	—	30,810
1993 Series A, bearing interest rates ranging from 4.6% to 5.25%, with maturity dates ranging from November 1, 2003 to 2019	90,950	—	44,215	46,735
1994 Series A, bearing a variable interest rate, with maturity dates ranging from November 1, 2003 to 2024	35,100	—	800	34,300
1998 Series A, bearing interest rates ranging from 5.0% to 5.125%, with maturity dates ranging from November 1, 2014 to 2015	12,960	—	—	12,960
1998 Series C, bearing interest rates ranging from 4.5% to 5.2%, with maturity dates ranging from November 1, 2003 to 2021	11,260	—	10	11,250
1998 Series D, bearing interest rates ranging from 4.5% to 5.0%, with maturity dates ranging from November 1, 2003 to 2028	122,730	—	2,505	120,225
2002 Series A, bearing interest rates ranging from 2.0% to 3.0%, with maturity dates ranging from November 1, 2003 to 2007	19,005	—	3,640	15,365
2003 Series A, bearing interest rates ranging from 2.4% to 4.0% with maturity dates ranging from November 1, 2004 to 2011	—	28,930	—	28,930
	322,815	28,930	51,170	300,575
<i>Less:</i>				
Unamortized loss on refunding	1,025	6,087	366	6,746
Unamortized issue discount	1,433	—	1,026	407
Net revenue bonds	\$320,357	22,843	49,778	293,422

Description	Balance at December 31, 2001	Additions	Reductions	Balance at December 31, 2002
<i>Revenue bonds:</i>				
1992 Series A, bearing interest rates ranging from 5.5% to 5.75%, with maturity dates ranging from November 1, 2002 to 2013	\$52,680	—	21,870	30,810
1993 Series A, bearing interest rates ranging from 4.6% to 5.25%, with maturity dates ranging from November 1, 2002 to 2019	93,650	—	2,700	90,950
1994 Series A, bearing a variable interest rate, with maturity dates ranging from November 1, 2002 to 2024	35,800	—	700	35,100
1998 Series A, bearing interest rates ranging from 5.0% to 5.125%, with maturity dates ranging from November 1, 2014 to 2015	12,960	—	—	12,960
1998 Series C, bearing interest rates ranging from 4.5% to 5.2%, with maturity dates ranging from November 1, 2002 to 2021	11,270	—	10	11,260
1998 Series D, bearing interest rates ranging from 4.5% to 5.0%, with maturity dates ranging from November 1, 2002 to 2028	125,125	—	2,395	122,730
2002 Series A, bearing interest rates ranging from 2.0% to 3.0%, with maturity dates ranging from November 1, 2003 to 2007	—	19,005	—	19,005
	331,485	19,005	27,675	322,815
<i>Less:</i>				
Unamortized loss on refunding	—	1,025	—	1,025
Unamortized issue discount	2,209	—	776	1,433
Net revenue bonds	\$329,276	17,980	26,899	320,357

Notes to Financial Statements

December 31, 2003 and 2002

Annual sinking fund requirements and debt principal and interest maturities for all future years are as follows (amounts in thousands):

	Revenue bonds	
	Principal	Interest
2004	\$10,355	14,758
2005	10,835	14,435
2006	11,140	14,075
2007	11,585	13,677
2008	12,275	13,220
2009-2013	70,915	56,280
2014-2018	77,350	36,333
2019-2023	56,780	17,776
2024-2028	39,340	5,501
	\$300,575	186,055

(a) Prior Year Debt Refunding

In the aggregate, \$198,260,000 remains outstanding at December 31, 2003 on the bond issues that were defeased "in-substance" during prior years.

(b) Trusteed and Nontrusteed Cash and Investments

The Commission has established both trusteed and nontrusteed funds with investments, principally short-term securities, which are restricted for payment of specified liabilities, capital projects, or other costs of operations. The components of the trusteed and nontrusteed investments at December 31, 2003 and 2002 are as follows:

	2003	2002
Trusteed:		
U.S. Treasury notes	\$ —	22,198,506
Other government obligations	106,945,246	96,777,725
Money market and cash investments	1,777,909	6,741,136
Open-ended mutual funds	8,601,319	10,818,223
Commercial paper	28,176,876	34,891,713
Repurchase agreements	8,416,250	8,416,250
	153,917,600	179,843,553
Nontrusteed:		
Other government obligations	439,619	617,126
Money market and cash investments	1,586,052	1,233,368
Open-ended mutual funds	38,215,494	57,450,439
Commercial paper	13,014,920	12,997,056
	53,256,085	72,297,989
	207,173,685	252,141,542
Less trusteed and nontrusteed cash	(3,363,961)	(7,974,504)
Trusteed and nontrusteed investments	\$203,809,724	244,167,038

See accompanying notes to financial statements.

(c) **Long-Term Notes Payable**

During 1997 and 1996, the Commission executed loan agreements with the Massachusetts Water Pollution Abatement Trust (MWPAT) to finance and refinance a portion of the Commission's water pollution abatement projects. For purposes of offsetting principal and interest payments, an amount aggregating \$13,819,948, consisting of contract assistance payments from the Commonwealth of Massachusetts and other interest subsidies from MWPAT, will be recognized as capital grants over the remaining term of the loan.

The scheduled loan payments for all MWPAT obligations and related subsidies are shown below (amounts in thousands):

	Loan subsidy amounts								
	Scheduled loan repayments			Equity earnings	Contract assistance payments	Total	Net loan repayments		
	Principal	Interest	Total				Principal	Interest	Total
2004	\$1,446	1,191	2,637	581	857	1,438	952	247	1,199
2005	1,510	1,115	2,625	542	859	1,401	992	232	1,224
2006	1,573	1,031	2,604	501	862	1,363	1,029	212	1,241
2007	1,647	940	2,587	458	862	1,320	1,075	192	1,267
2008	1,728	845	2,573	413	859	1,272	1,137	172	1,309
2009-2013	9,942	2,632	12,574	1,308	4,245	5,553	6,499	509	7,008
2014-2018	4,343	381	4,724	203	1,269	1,472	3,180	42	3,222
	\$22,189	8,135	30,324	4,006	9,813	13,819	14,864	1,606	16,470

Notes to Financial Statements

December 31, 2003 and 2002

The Commission has entered into various interest-free loan agreements with the Massachusetts Water Resources Authority (the Authority). Under these agreements, the Commission is required to repay these loans in annual installments as part of the Authority's Infiltration/Inflow Local Financial Assistance program (I/I). Local Water Infrastructure Rehabilitation Program (WIR) and Pipeline Assistance Program (PAP). These programs are designed to assist service area communities with sewer system rehabilitation.

The following is a summary of long-term note activities for the years ended December 31, 2003 and 2002:

Description	Balance at December 31, 2002	Additions	Reductions	Balance at December 31, 2003
MWRA I/I Program Phase II, interest free, due November 15, 2003	\$221,797	—	221,797	—
MWRA I/I Program Phase III, interest free, due November 15, 2004	1,088,418	1,603,529	659,649	2,032,298
MWRA I/I Program Phase IV, interest free, due February 15, 2008	—	3,501,589	—	3,501,589
MWRA W.I.R. Program, interest free, due November 15, 2004	1,416,015	—	1,083,494	332,521
MWRA P.A.P. Program, interest free, due November 15, 2011	17,424,649	6,154,777	1,847,141	21,732,285
MWPAT Pool I, subsidized interest, due August 1, 2013	7,354,257	—	507,298	6,846,959
MWPAT Pool II, subsidized interest, due August 1, 2015	6,535,728	—	357,378	6,178,350
MWPAT Pool III, subsidized interest, due February 1, 2017	9,693,950	—	530,358	9,163,592
Total long-term notes	\$43,734,814	11,259,895	5,207,115	49,787,594

Description	Balance at December 31, 2001	Additions	Reductions	Balance at December 31, 2002
MWRA I/I Program Phase II, interest free, due November 15, 2003	\$549,194	—	327,397	221,797
MWRA I/I Program Phase III, interest free, due November 15, 2004	1,748,067	—	659,649	1,088,418
MWRA W.I.R. Program, interest free, due November 15, 2004	3,361,786	—	1,945,771	1,416,015
MWRA P.A.P. Program, interest free, due November 15, 2011	7,743,515	10,480,250	799,116	17,424,649
MWPAT Pool I, subsidized interest, due August 1, 2013	7,837,653	—	483,396	7,354,257
MWPAT Pool II, subsidized interest, due August 1, 2015	6,876,086	—	340,358	6,535,728
MWPAT Pool III, subsidized interest, due February 1, 2017	10,096,359	—	402,409	9,693,950
Total long-term notes	\$38,212,660	10,480,250	4,958,096	43,734,814

(5) Current Refunding

On November 1, 2003, the Commission issued \$28,930,000 in Series A General Revenue Refunding Bonds with an interest rate range of 2.4% to 4.0% to refund an \$41,390,000 portion of outstanding 1993 Series A General Revenue Bonds with an interest rate range of 5.0% to 5.25%. The new bonds require eight debt service payments with the final payment due on November 1, 2011. The net proceeds of \$29,258,478 plus \$12,959,328 and \$1,082,564 from the senior debt service reserve and senior debt service funds, respectively, were used to purchase State and Local Government Series Certificate of Indebtedness and notes. These securities were deposited in a current refund trust fund with an escrow agent to provide for the final debt service payment on the bonds. As a result, the bonds are considered to be defeased and the liability has been removed.

The Commission refunded the 1993 bonds to reduce its total debt service payments over the next eight years by \$19,445,297 and to obtain an economic gain (the difference between the present value of the debt service payments on the old debt and the new debt) of \$16,326,787.

(6) Massachusetts Water Resources Authority

The MWRA provides all the Commission's water supply and sewer treatment requirements and assesses the Commission for a portion of its actual operating and capital expenses. The assessment is based on the MWRA's fiscal year (July 1 to June 30), and payments are due to the Authority in ten equal installments excluding the months of January and July. Amounts included in the statements of operations for assessments by the Authority for 2003 and 2002 are as follows:

	2003	2002
<i>Assessments allocated on:</i>		
Water usage	\$46,875,982	43,369,447
Wastewater usage	88,309,622	79,367,563
Total	\$135,185,604	122,737,010

In 2003 and 2002, over 78% of water provided from the Authority was billable to customers. Since its inception, the Commission has maintained the percentage of billable water at 78% and is continuing to take steps to improve the amount of billable water, including replacement of old and defective meters and implementation of a comprehensive leak detection and repair program.

(7) Transactions with the City of Boston

The Commission's ongoing program to meter City facilities has resulted in billings to ten City departments during 2003 and 2002, respectively, based on actual consumption of \$4,652,674 and \$4,386,765 in 2003 and 2002, respectively.

The City provides services to the Commission, including paving and facilities rental. Operating costs billed to the Commission by the City were \$1,200,552 and \$857,710 during 2003 and 2002, respectively. Capital costs billed by the City were \$2,678,231 and \$2,097,599 during 2003 and 2002, respectively.

The Commission has an agreement with the City that allows the Commission's water and sewer bills that have remained unpaid for more than two years to be added as liens on the City's property tax bills. Under this agreement, the City provides collection services on these bills for an administrative fee. As of December 31, 2003, receivables totaling approximately \$1.5 million of billings had been included on property tax bills.

Under the Commission's own tax lien program, accounts which have unpaid balances over two years old are transferred into the tax lien program for collection. As of December 31, 2003 and 2002, \$2,380,564 and \$3,191,929, respectively, remains outstanding.

(8) Retirement Benefits

The Commission provides retirement benefits to substantially all of its employees through the State-Boston Retirement System (SBRS or the System). The Commission does not provide any other significant postemployment benefits.

A dispute concerning the Commission's past and future obligations to all Commission employees covered by the SBRS was settled in 1986, resulting in a payment of \$19,100,000 to the SBRS. This payment was funded primarily through 1985 and 1986 bond proceeds and is recorded as a deferred charge that will be recovered through future rates. As part of the settlement with the SBRS, the Commission annually reimburses the City for the Commission's share of pension benefits paid to Commission employees. The Commission's share is based upon the proportion of each employee's total years of creditable service, level of compensation, and group classification. Employees become 100% vested after ten years of creditable service as defined by Chapter 32 of the Massachusetts General Laws (MGL).

Notes to Financial Statements

December 31, 2003 and 2002

(a) Description of the SBRS Plan

The SBRS is a cost-sharing multi-employer public employee retirement system established under Chapter 32 of the MGL and is a member of the Massachusetts Contributory Retirement System. The System provides retirement, disability, and death benefits to plan members and beneficiaries. Chapter 32 of the MGL assigns authority to establish and amend benefit provisions of the plan. The System issues a publicly available financial report which can be obtained through the Commonwealth of Massachusetts, Public Employee Retirement Administration Commission (PERAC), One Ashburton Place, Boston, Massachusetts 02108.

(b) Funding Policy

Plan members are required to contribute to the SBRS at rates ranging from 5% to 11% of annual covered compensation. The Commission is required to pay into the SBRS its share of the remaining systemwide actuarially determined contribution plus administration costs which are apportioned among the employers based on active covered payroll. Through fiscal 1998, the Commonwealth of Massachusetts reimbursed the SBRS for a portion of benefit payments for cost-of-living increases. Beginning July 1, 1998, the SBRS is locally funding the cost-of-living adjustments as approved by the SBRS' Board of Retirement, the City's Mayor, and City Council. The contributions of plan members and the Commission are governed by Chapter 32 of the MGL. The Commission's contributions to the System for the years ended December 31, 2003, 2002, and 2001 were approximately \$456,264, \$481,719, and \$565,350, respectively, which equaled its required contribution each year. Total employee contributions, based on actuarially determined amounts, were approximately \$1,946,993, \$2,001,820, and \$1,929,788, or 8.5%, 8.3%, and 8.2% of covered payroll in 2003, 2002, and 2001, respectively.

(c) The Commission's Trust Fund

On a quarterly basis, the Commission deposits an amount into a Trust Fund, the assets of which are used to reimburse the SBRS for amounts paid on behalf of the Commission. As required by the Commission's Enabling Act, employee pension contributions are transferred to the SBRS directly and are either returned to employees upon termination or, for vested employees, are used to defray a portion of the total retirement benefit. The Commission's policy is to make employer contributions to the Trust Fund based upon the actuarially determined cost of future benefits, net of employee contributions.

Trust Fund assets at December 31, 2003 and 2002 are as follows:

	2003	2002
Assets (at fair value):		
Common stock	\$32,005,754	23,777,945
International stock	8,192,654	5,394,386
Mutual funds	1,012,557	977,983
Fixed income	24,870,128	25,464,818
Total	\$66,081,093	\$55,615,132

The Trust Fund activity is as follows:

Assets (at fair value), January 1, 2002	\$63,440,036
Employer contributions	481,719
Investment losses	(6,614,536)
Management fees	(224,409)
Payments to SBRS	(1,467,678)
Assets (at fair value), December 31, 2002	\$55,615,132
Employer contributions	456,264
Investment income and gains	12,505,237
Management fees	(286,072)
Payments to SBRS	(2,209,468)
Assets (at fair value), December 31, 2003	\$66,081,093

The investment portfolio is regulated by the MGL, Chapter 32, Section 23. The investments are managed by independent investment advisors. Fleet Bank of Massachusetts, N.A. is the custodian of the portfolio. The Trust Fund assets will be used by the Commission to reimburse SBRS in future years for required employer contributions.

(9) Deposits and Investments

The Commission's General Revenue Bond Resolution, adopted December 6, 1984, as amended, places certain limitations on the nature of deposits and investments available to the Commission. Demand deposits and term deposits without collateralization can only be made with financial institutions meeting certain criteria. Certificates of deposit must be fully collateralized and issued by FDIC-insured banks. Investments can also be made in securities issued by or unconditionally guaranteed by the U.S. Government or its agencies; public agencies, municipalities, or state obligations carrying the highest bond rating; commercial paper rated A-1, P-1; A Rated money market funds; fully collateralized investment contracts and certain futures contracts. In addition, the Commission's Trust Fund has additional investment powers, most notably the ability to invest in stocks, corporate bonds, and other instruments.

(a) Deposits

A summary of the Commission's deposits that are (Category 1) fully insured or collateralized with securities held by the Commission or its agent in the Commission's name, (Category 2) those deposits that are collateralized with securities held by the pledging financial institution's trust department or agent in the Commission's name, and (Category 3) those deposits that are not collateralized as of December 31, 2003 and 2002 follows:

2003	Category			Total bank balance	Carrying amount
	1	2	3		
Cash	\$100,000	—	8,595,758	8,695,758	8,135,734
Bank money market deposits	—	—	3,363,961	3,363,961	3,363,961
Total	\$100,000	—	11,959,719	12,059,719	11,499,695

2002	Category			Total bank balance	Carrying amount
	1	2	3		
Cash	\$100,000	—	10,110,187	10,210,187	9,340,446
Bank money market deposits	—	—	7,974,504	7,974,504	7,974,504
Total	\$100,000	—	18,084,691	18,184,691	17,314,950

Deposits in transit and outstanding checks account for the majority of the difference between the bank balance and the carrying amount.

(b) Investments

The Commission's investments are categorized according to the level of custodial credit risk assumed by the Commission. Category 1 includes investments that are insured, registered, or held by the Commission's trustee in the Commission's name. Category 2 includes uninsured and unregistered investments held by the counterparty's trust department or agent in the Commission's name. Category 3 includes uninsured or unregistered investments held by the counterparty, its trust department, or agent but not in the Commission's name.

Notes to Financial Statements

December 31, 2003 and 2002

2003	Category			Fair value	
	1	2	3		
Categorized:					
U.S. Government agency obligations	\$	—	107,384,865	—	107,384,865
Repurchase agreements		—	8,416,250	—	8,416,250
Commercial paper		—	41,191,796	—	41,191,796
Total	\$	—	156,992,911	—	156,992,911
Not categorized:					
Open-end mutual funds					46,816,813
Total					\$203,809,724

2002	Category			Fair value	
	1	2	3		
Categorized:					
U.S. Government obligations	\$	—	22,198,506	—	22,198,506
U.S. Government agency obligations		—	97,394,851	—	97,394,851
Repurchase agreements		—	8,416,250	—	8,416,250
Commercial paper		—	47,888,769	—	47,888,769
Total	\$	—	175,898,376	—	175,898,376
Not categorized:					
Open-end mutual funds					68,268,662
Total					\$244,167,038

The investment portfolio is regulated by the MGL, Chapter 32, Section 23. The investments are presented in the financial statements at fair market value. U.S. Bank and Trust Company is the custodian of the portfolio, which is managed by independent investment advisors.

(10) Lease Commitments

The Commission leases office space and equipment under various leases that have been accounted for as operating leases. The payments received under these leases are not material.

Rent expense under operating leases amounted to \$95,866 and \$81,918 in 2003 and 2002, respectively.

(11) Commitments

A major capital improvement program is currently in progress. As part of this program, the Commission has entered into a number of contracts for the design and construction of its facilities. Commitments under these contracts aggregate approximately \$71.5 million as of December 31, 2003. Capital improvements, primarily related to water and wastewater system projects with an emphasis on the cleanup of the Boston Harbor area, are expected to aggregate approximately \$135.7 million for 2003 through 2004. Of this amount, approximately \$116 million represents extension and improvement projects and \$19.7 million represents renewal and replacement projects. The extension and improvement projects are expected to be 51% funded by federal and state grants and Authority grants and loans. The remaining amounts will be funded from the Commission's bond proceeds and operating revenues.

(12) Risk Management and Other Insurance

The Commission carries self-insured retention limits for claims filed under workers' compensation and general liability and completely self insures for all unemployment benefits. The workers' compensation self-insured retention limit is \$750,000 per claim and is supplemented with \$5 million in excess coverage purchased through an outside carrier. For general liability, the Commission's self-insured limits are \$1 million per occurrence, \$2.5 million aggregate, and are subordinate to \$5 million of excess coverage purchased through an outside carrier. Under the sections of the Model Water and Sewer Act, the Commission's tort liability is capped at \$100,000 per claimant.

The Commission maintains other insurance coverage as follows:

Policy type	Coverage
Health	Premium based
Vehicles	Combined single limit of \$1 million
Property	Aggregate limit of \$65.9 million
Public officials	Coverage of \$3 million; \$100,000 self-insurance retention
Fiduciary	\$2 million coverage
Crime	Employee dishonesty coverage of \$5 million

The Commission participates in the City's health benefits plans for which the City assesses monthly premiums to the Commission based on current enrollments. Insurance claims for all policies have not exceeded coverage by a material amount in the past three years.

Liabilities for self-insured claims are reported if it is probable that a loss has been incurred and the amount can be reasonably estimated. The Commission has established a liability based on historical trends of previous years and attorney's and independent insurance reserve appraiser's estimates of pending matters and lawsuits in which the Commission is involved. Unemployment claims paid during 2003 and 2002 were immaterial.

Changes for the years ended December 31, 2003 and 2002 are as follows:

	2003	2002
Beginning balance of reserves	\$3,333,077	2,854,971
Payment of claims attributable to events of both current and prior years:		
Workers' compensation	(339,895)	(333,044)
General liability	(403,689)	(252,215)
Incurred claims	598,678	1,063,365
Ending balance of reserves	\$3,188,171	3,333,077

Incurred claims represent the total of a provision for events of the current fiscal year and any change in the provision for events of the prior fiscal years.

(13) Contingencies

The Commission is involved in ordinary and routine litigation and other matters related to its operations and the establishment of rates. Management believes that the resolution of these matters will not materially affect the financial position of the Commission.

The Commission has received federal and state grants for specific purposes that are subject to review and audit by the grantor agencies. Such audits could lead to requests for reimbursement to the grantor agency for expenditures disallowed under terms of the grant. The Commission believes such disallowances, if any, will not be significant.

The Commission is involved as a defendant in litigation regarding the pollution of Boston Harbor. Management believes that the Commission's extensive capital improvement program (see note 11) addresses probable actions that the Commission may be required to undertake in connection with this litigation. Additionally, the Commission is likely to bear either directly or through future assessments of the MWRA a substantial portion of the financial costs involved. As of December 31, 2003, the overall cleanup costs are estimated to be approximately \$600 million. However, the extent of the Commission's liability for these costs cannot be determined.

Supplemental Schedule of Revenues and Expenses - Rate Basis

Years ended December 31, 2003 and 2002

	2003	2002
Revenues:		
Water revenue	\$85,996,060	77,877,004
Sewer revenue	119,004,280	109,197,117
Subtotal	205,000,340	187,074,121
Less:		
Adjustments	6,095,736	4,439,652
Discounts	867,894	777,021
Bad debt	786,729	386,581
Subtotal	7,750,359	5,603,254
Net billed charges	197,249,981	181,470,867
Prior year surplus	438,608	421,425
Miscellaneous revenues:		
Late charge revenue	1,309,806	1,241,285
Investment income	6,535,345	7,934,508
Fire pipe revenue	3,108,779	2,922,124
Other income	13,806,299	15,118,128
Total revenues	222,448,818	209,108,337
Direct operating expenses:		
Salaries and wages	24,101,884	25,558,712
Overtime wages	686,946	521,971
Fringe benefits	4,526,164	5,364,521
Supplies and materials	2,013,603	2,103,293
Repairs and maintenance	7,704,164	6,974,382
Utilities	1,090,693	1,121,739
Professional services	2,834,941	2,790,215
Space and equipment rentals	95,867	87,598
Other services	1,201,341	1,318,834
Insurance	701,958	579,282
Travel and training	53,754	—
Damage claims	721,690	11,477
Inventory	7,059	1,673
Capital outlay	623,996	23,513
Total direct operating expenses	46,364,060	46,457,210
Nonoperating expenses:		
MWRA assessment	135,185,604	122,737,010
Capital improvements	10,144,410	8,876,812
Principal payments	14,518,527	13,580,172
Interest expense	14,596,027	15,797,444
Deposits to reserve funds	855,201	978,578
SDWA assessment	257,185	242,503
Total nonoperating expenses	175,556,954	162,212,519
Total current expenses	221,921,014	208,669,729
Current year rate surplus	\$527,804	438,608

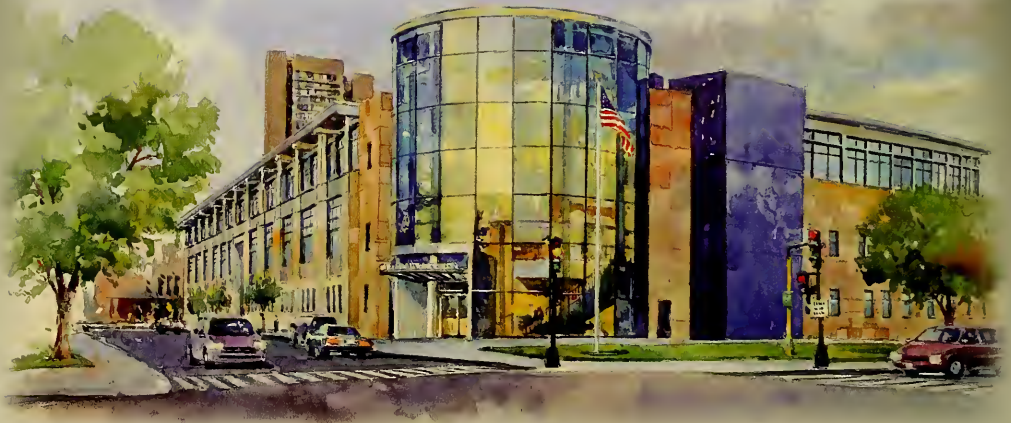
This supplemental schedule presents the Commission's revenues and expenses on the basis that is presented in the Commission's budget and rate-setting documents.

See accompanying independent auditors' report.



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